

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, California 94105**

TEXT OF PROPOSED REGULATIONS

**File Number RH04041191
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California Code of Regulations Title 10 Chapter 5 Subchapter 3 Article 3.5

§2312. Claim Reserves.

(a) General Rules

(1) Claim reserves are required for all incurred but unpaid claims (these include all claims accrued and unaccrued, reported and unreported) on all disability insurance policies as defined in §2310(a).

(2) Appropriate claim expense reserves are required with respect to the estimated expense of settlement of all incurred but unpaid claims.

(3) All such reserves for prior valuation years are to be tested for adequacy and reasonableness along the lines of claim runoff schedules in accordance with the financial statement as required by Insurance Code §§900 and 923 including consideration of any residual unpaid liability.

(b) Minimum Standards for Claim Reserves

(1) Disability Income

(A) Interest. The maximum interest rate for claim reserves is specified in §2315.

(B) Morbidity. Minimum standards with respect to morbidity are those specified in §2315; except that, at the option of the insurer:

1. For individual disability income claims incurred on or after January 1, 2005, ~~assumptions regarding claim termination rates for the period less than two (2) years from the date of disablement~~ claims with a duration from date of disablement of less than two years, reserves may be based on the insurer's experience, if such experience is credible, or upon other assumptions designed to place a sound value on the liabilities.

2. For group disability income claims incurred on or after January 1, 2005:

(i) Assumptions regarding claim termination rates for the period less than two (2) years from the date of disablement may be based on the insurer's experience, if the experience is considered credible, or upon other assumptions designed to place a sound value on the liabilities.

(ii) Assumptions regarding claim termination rates for the period of two (2) or more years but less than five (5) years from the date of disablement with a duration from date of disablement of more than two years but less than five years, reserves may, with the approval of the Commissioner, be based upon the insurer's experience for which the insurer maintains underwriting and claim administration control. The request for such approval of a plan of modification to the reserve basis must include:

I. A. An analysis of the credibility of the experience;

II. B. A description of how all of the insurer's experience is proposed to be used in setting reserves;

III. C. A description and quantification of the margins to be included;

IV. D. A summary of the financial impact that the proposed plan of modification would have had on the insurer's last filed annual statement;

V. E. A copy of the approval of the proposed plan of modification by the Commissioner of the state of domicile; and

VI. F. Any other information requested by the Commissioner.

3. For disability income claims incurred prior to January 1, 2005 each insurer may elect which of the following to use as the minimum morbidity standard for claim reserves:

(i) The minimum morbidity standard in effect for claim reserves as of the date the claim was incurred, or

(ii) The standards as defined in Items 1. and 2., applied to all open claims. Once an insurer elects to calculate reserves for all open claims on the standard defined in Items 1. and 2., all future valuations must be on that basis.

(C) Duration of Disablement. For contracts with an elimination period, the duration of disablement shall be measured as dating from the time that benefits would have begun to accrue had there been no elimination period.

(2) All Other Benefits

(A) Interest. The maximum interest rate for claim reserves is specified in §2315.

(B) Morbidity or other Contingency. The reserve shall be based on the insurer's experience, if such experience is considered credible, or upon other assumptions designed to place a sound value on the liabilities.

(c) Claim Reserve Methods Generally

Any generally accepted or reasonable actuarial method or combination of methods may be used to estimate all claim liabilities. The methods used for estimating liabilities generally may be aggregate methods, or various reserve items may be separately valued employed. Approximations based on groupings and averages may also be employed. Adequacy of the claim reserves, however, shall be determined in the aggregate.

Authority. -- Sections 997(a) and 10489.95, Insurance Code. Reference: Sections 985, 997 and 10489.15(a), Insurance Code.

§2312.5. Contract Reserves.

(a) General Rules

(1) Contract reserves are required, unless otherwise specified in paragraph (a)(2) for:

(A) All individual and group contracts with which level premiums are used; or

(B) All individual and group contracts with respect to which, due to the gross premium pricing structure at issue, the value of the future benefits at any time exceeds the value of any appropriate future valuation net premiums at that time. This evaluation may be applied on a rating block basis if the total premiums for the block were developed to support the total risk assumed and expected expenses for the block each year, and a qualified actuary certifies the premium development. The actuary should state in the certification that premiums for the rating block were developed such that each year's premium was intended to cover that year's costs without any prefunding. If the premium is also intended to recover costs for any prior years, the actuary should also disclose the reasons for and magnitude of such recovery. The values specified in this paragraph shall be calculated based on subsection §2312.5(b).

(2) Contracts not requiring a contract reserve are:

(A) Contracts which cannot be continued after one year from issue; or

(B) Contracts already in force on the effective date of this article for which no contract reserve is required under Section 997 of the Insurance Code.

(3) The contract reserve shall be in addition to claim reserves and premium reserves.

(4) The methods and procedures for the calculation of contract reserves shall be consistent with those for claim reserves for any contract, or else appropriate adjustment shall be made when necessary to assure provision for the aggregate liability. The definition of the date of incurral must be the same in both determinations.

(5) The total contract reserve established shall incorporate provisions for moderately adverse deviations.

(b) Minimum Standards for Contract Reserves

(1) Basis.

(A) (1) Morbidity or other Contingency. Minimum standards with respect to morbidity are those set forth in §2315. Valuation net premiums used under each contract shall have a structure consistent with the gross premium structure at issue of the contract as this relates to advancing age of ~~or~~ insured, contract duration and period for which gross premiums have been calculated. Contracts for which tabular morbidity standards are not

specified in §2315 shall be valued using tables established for reserve purposes by a qualified actuary with the approval of the Commissioner. The morbidity tables shall contain a pattern of incurred claims cost that reflects the underlying morbidity and shall not be constructed for the primary purpose of minimizing reserves.

1. In determining the morbidity assumptions, the actuary shall use assumptions that represent the best estimate of anticipated future experience, but shall not incorporate any expectation of future morbidity improvement. Morbidity improvement is a change, in the combined effect of claim frequency and the present value of future expected claim payments given that a claim has occurred, from the current morbidity tables or experience that will result in a reduction to reserves. It is not the intent of this provision to restrict the ability of the actuary to reflect the morbidity impact for a specific known event that has occurred and that is able to be evaluated and quantified.

2. Business in force as of the effective date of §2312.5(b)(1)(C)2. may be permitted to retain the original reserve basis which may not meet the provisions of Item 1. above, subject to the acceptability to the Commissioner.

(B) ~~(2)~~ Interest. The maximum interest rate is specified in §2315.

(C) ~~(3)~~ Termination Rates. Termination rates used to compute reserves shall be on the basis of a mortality table as specified in §2315 except as noted in the following paragraphs:

1. Under contracts for which premiums rates are not guaranteed, and where the effects of insurer underwriting are specifically used by policy duration in the valuation morbidity standard or for return of premium or on other deferred cash benefits, total termination rates may be used at ages and durations where these exceed specified mortality table rates, but not in excess of the lesser of:

(i) ~~(A)~~ Eighty percent of the total termination rate used in the calculation of the gross premium, or

(ii) ~~(B)~~ Eight percent.

2. For long-term care individual policies or group certificates issued on or after January 1, 2005, the contract reserve shall be established on the basis of:

(i) Mortality (as specified in §2315); and

(ii) Terminations other than mortality, where the terminations are not to exceed:

I. For policy year one, the lesser of eighty percent (80%) of the voluntary lapse rate used in the calculation of gross premiums and six percent (6%);

II. For policy years two (2) through four (4), the lesser of eighty percent (80%) of the voluntary lapse rate used in the calculation of gross premiums and four percent (4%); and

III. For policy years five (5) and later, the lesser of one hundred percent (100%) of the voluntary lapse rate used in the calculation of gross premiums and two percent (2%), except for group insurance as defined in Section 10231.6 of the Insurance Code, where the 2% shall be three percent (3%)

3. Where a morbidity standard specified in §2315 is on an aggregate basis, such morbidity standard may be adjusted to reflect the effect of insurer underwriting by policy duration. The adjustments shall be appropriate to the underwriting and must be approved by the Commissioner.

(2) ~~(4)~~ Reserve Method.

(A) For all disability insurance as defined in §2310(a) except for contracts issued on or after January 1, 1995, which provides long-term care and return of premium or other deferred cash benefits, the minimum reserve shall be the reserve calculated on the two-year full preliminary term method; that is, under which the terminal reserve is zero at the first and also the second contract anniversary.

(B) For long-term care insurance issued on or after January 1, 1995, the minimum reserve shall be the reserve calculated on the one-year full preliminary term method.

(C) For return of premium or other deferred cash benefits issued on or after January 1, 1995, the minimum reserve shall be the reserve calculated as follows:

1. On the one year preliminary term method if such benefits are provided at any time before the twentieth anniversary;
2. On the two year preliminary term method if such benefits are only provided on or after the twentieth anniversary.

(D) The preliminary term method may be applied only in relation to the date of issue of a contractual obligation. Reserve adjustments introduced later, as a result of rate increases, revisions in assumptions (e.g., projected inflation rates) or for other reasons, shall be applied immediately as of the effective date of adoption of the adjusted basis.

(3) ~~(5)~~ Negative Reserves.

Negative reserves on any benefit may be offset against positive reserves for other benefits in the same contract, but the total contract reserve with respect to all benefits combined shall not be less than zero.

(4) Nonforfeiture Benefits for Long-Term Care Insurance.

The contract reserve on a policy basis shall not be less than the net single premium for the nonforfeiture benefits at the appropriate policy duration, where the net single premium is computed according to the above specifications.

(c) Alternative Valuation Methods and Assumptions Generally

Provided the contract reserve on all contracts to which an alternative method or basis is applied is not less in the aggregate than the amount determined according to the applicable standards specified above, an insurer may use any reasonable assumptions as to interest rates, termination and/or mortality rates, and rates of morbidity or other contingency. Also subject to the preceding condition, an insurer may employ methods other than the methods stated above in determining a sound value of its liabilities under such contracts, including, but not limited to the following: the net level premium method; the one-year full preliminary term method; prospective valuation on the basis of actual gross premiums with reasonable allowance for future expenses; the use of approximations such as those involving age groupings, groupings of several years of issue, average amounts of indemnity, grouping of similar contract forms; the computation of the reserve for one contract benefit as a percentage of, or by other relation to, the aggregate contract reserves exclusive of the benefit or benefits so valued; and the use of a composite annual claim for all or any combination of the benefits included in the contracts valued.

(d) Tests For Adequacy and Reasonableness of Contract Reserves

Annually, an appropriate review shall be made of the insurer's prospective contract liabilities on contracts valued by tabular reserves, to determine the continuing adequacy and reasonableness of the tabular reserves, giving consideration to future gross premiums. The insurer shall make appropriate increases to such tabular reserves if such tests indicate that the basis of such reserves is no longer adequate subject to the minimum standards in subsection (b).

If an insurer has a contract or a group of related similar contracts, for which future gross premiums will be restricted by contract, insurance department regulations, or for other reasons, such that the future gross premiums reduced by expenses for administration, commissions and taxes will be insufficient to cover future claims, the insurer shall establish contract reserves for such shortfall in the aggregate.

Authority. -- Sections 997(a) and 10489.95, Insurance Code. Reference: Sections 985, 997 and 10489.15(a), Insurance Code.

§2315. Specific Standards for Morbidity, Interest and Mortality.

(a) Morbidity

(1) Minimum morbidity standards for valuation of specified individual contract benefits:

(A) Disability Income Benefits Due to Accident or Sickness.

1. Contract Reserves

For contracts issued on or after January 1, 1965 and prior to January 1, 1995: use either the 1964 Commissioners Disability Table or the 1985 Tables described below.

For contracts issued on or after January 1, 1995: The 1985 Commissioners Individual Disability Tables A (85CIDA); or The 1985 Commissioners Individual Disability Tables B (85CIDB). 85CIDA, also called the Basic Valuation Table, is found in Transactions of the Society of Actuaries, Volume XXXVII, pages 449- 460. 85CIDB, also called the "83c Table," is found in Proceedings of the NAIC, 1985, Volume 1, pages 494- 540.

Each insurer shall elect, with respect to all individual contracts issued in any one statement year, either Tables A or Tables B as the minimum standard. The insurer may elect to use the other tables with respect to any subsequent statement year.

2. Claim Reserves

(i) For claims incurred on or after January 1, 2005:

The 1985 Commissioners Individual Disability Table A (85CIDA) with claim termination rates multiplied by the following adjustment factors:

<u>Duration</u>	<u>Adjustment Factor</u>	<u>Adjusted Termination Rates*</u>
<u>Week 1</u>	<u>0.366</u>	<u>0.04831</u>
<u>2</u>	<u>0.366</u>	<u>0.04172</u>
<u>3</u>	<u>0.366</u>	<u>0.04063</u>
<u>4</u>	<u>0.366</u>	<u>0.04355</u>
<u>5</u>	<u>0.365</u>	<u>0.04088</u>
<u>6</u>	<u>0.365</u>	<u>0.04271</u>
<u>7</u>	<u>0.365</u>	<u>0.04380</u>
<u>8</u>	<u>0.365</u>	<u>0.04344</u>
<u>9</u>	<u>0.370</u>	<u>0.04292</u>
<u>10</u>	<u>0.370</u>	<u>0.04107</u>
<u>11</u>	<u>0.370</u>	<u>0.03848</u>
<u>12</u>	<u>0.370</u>	<u>0.03478</u>
<u>13</u>	<u>0.370</u>	<u>0.03034</u>
<u>Month 4</u>	<u>0.391</u>	<u>0.08758</u>

<u>5</u>	<u>0.371</u>	<u>0.07346</u>
<u>6</u>	<u>0.435</u>	<u>0.07531</u>
<u>7</u>	<u>0.500</u>	<u>0.07245</u>
<u>8</u>	<u>0.564</u>	<u>0.06655</u>
<u>9</u>	<u>0.613</u>	<u>0.05520</u>
<u>10</u>	<u>0.663</u>	<u>0.04705</u>
<u>11</u>	<u>0.712</u>	<u>0.04486</u>
<u>12</u>	<u>0.756</u>	<u>0.04309</u>
<u>13</u>	<u>0.800</u>	<u>0.04080</u>
<u>14</u>	<u>0.844</u>	<u>0.03882</u>
<u>15</u>	<u>0.888</u>	<u>0.03730</u>
<u>16</u>	<u>0.932</u>	<u>0.03448</u>
<u>17</u>	<u>0.976</u>	<u>0.03026</u>
<u>18</u>	<u>1.020</u>	<u>0.02856</u>
<u>19</u>	<u>1.049</u>	<u>0.02518</u>
<u>20</u>	<u>1.078</u>	<u>0.02264</u>
<u>21</u>	<u>1.107</u>	<u>0.02104</u>
<u>22</u>	<u>1.136</u>	<u>0.01932</u>
<u>23</u>	<u>1.165</u>	<u>0.01865</u>
<u>24</u>	<u>1.195</u>	<u>0.01792</u>
<u>Year 3</u>	<u>1.369</u>	<u>0.16839</u>
<u>4</u>	<u>1.204</u>	<u>0.10114</u>
<u>5</u>	<u>1.199</u>	<u>0.07434</u>
<u>6 and later</u>	<u>1.000</u>	<u>**</u>

* The adjusted termination rates derived from the application of the adjustment factors to the DTS Valuation Table termination rates shown in exhibits 3a, 3b, 3c, 4, and 5 (Transactions of the Society of Actuaries (TSA) XXXVII, pp. 457-463) are displayed.

The adjustment factors for age, elimination period, class, sex, and cause displayed in exhibits 3a, 3b, 3c, and 4 should be applied to the adjusted termination rates shown in this table.

** Applicable DTS Valuation Table duration rate from exhibits 3c and 4 (TSA XXXVII, pp. 462-463).

The 85CIDA table so adjusted for the computation of claim reserves shall be known as 85CIDC (The 1985 Commissioners Individual Disability Table C).

(ii) For claims incurred prior to January 1, 2005:

Each insurer may elect which of the following to use as the minimum standard for claims incurred prior to January 1, 2005:

(I) The minimum morbidity standard in effect for contract reserves on currently issued contracts, as of the date the claim is incurred, or

(II) The standard as defined in Item (i), applied to all open claims.

(III) Once an insurer elects to calculate reserves for all open claims on the standard defined in Item (i), all future valuations must be on that basis.

(B) Hospital Benefits, Surgical Benefits and Maternity Benefits (Scheduled benefits or fixed time period benefits only).

1. Contract Reserves

For contracts issued on or after January 1, 1955, and before January 1, 1982: The 1956 Intercompany Hospital-Surgical Tables.

For contracts issued on or after January 1, 1982: The 1974 Medical Expense Tables, Table A, Transactions of the Society of Actuaries, Volume XXX, pg. 63. Refer to the paper (in the same volume, pg. 9) to which this table is appended, including its discussions, for methods of adjustment for benefits not directly valued in Table A: "Development of the 1974 Medical Expense Benefits," Houghton and Wolf.

2. Claim Reserves: No specific standard. See paragraph (E).

(C) Cancer Expense Benefits (Scheduled benefits or fixed time period benefits only).

1. Contract Reserves

For contracts issued on or after January 1, 1986: The 1985 NAIC Cancer Claim Cost Tables.

2. Claim Reserves: No specific standard. See paragraph (E).

(D) Accidental Death Benefits

1. Contract Reserves

For contracts issued on or after January 1, 1965: The 1959 Accidental Death Benefits Table.

2. Claim Reserves: Actual amount incurred.

(E) Other Individual Contract Benefits

1. Contract Reserves

For all other individual contract benefits, morbidity assumptions are to be determined as provided in this article.

2. Claim Reserves

For all benefits other than disability income, claim reserves are to be determined as provided in this article.

(2) Minimum morbidity standards for valuation of specified group contract benefits:

(A) Disability Income Benefits Due to Accident or Sickness.

1. Contract Reserves

For contracts issued prior to January 1, 1995: The same basis, if any, as that employed by the insurer as of January 1, 1995

For contracts issued on or after January 1, 1995: The 1987 Commissioners Group Disability Income Table (87CGDT; Transactions of the Society of Actuaries, Volume XXXIX, pages 393- 458).

2. Claim Reserves

For claims incurred on or after January 1, 1995: The 1987 Commissioners Group Disability Income Table (87CGDT; Transactions of the Society of Actuaries, Volume XXXIX, pages 393- 458).

For claims incurred prior to January 1, 1995: Use of the 87CGDT is optional.

(B) Other Group Contract Benefits

1. Contract Reserves

For all other group contract benefits, morbidity assumptions shall be determined as provided in this article.

2. Claim Reserves

For all benefits other than disability income, claim reserves shall be determined as provided in this article.

(b) Interest

(1) For contract reserves the maximum interest rate shall be the maximum rate permitted by Insurance Code §10489.4 in the valuation of whole life insurance issued on the same date as the disability insurance contract.

(2) For claim reserves on policies that require contract reserves, the maximum interest rate shall be the maximum rate permitted by Insurance Code §10489.4 in the valuation of whole life insurance issued on the same date as the claim incurral date.

(3) For claim reserves on policies not requiring contract reserves, the maximum interest rate shall be the maximum rate permitted by Insurance Code §10489.4 in the valuation of single premium immediate annuities issued on the same date as the claim incurral date, reduced by one hundred basis points.

(c) Mortality

(1) Except as provided in paragraph ~~(2)~~ (3), the mortality basis used for ~~active lives~~ all policies, except long-term care individual policies and group certificates issued on or after January 1, 2005, shall be:

(i) for active lives according to a table (but without use of selection factors) permitted by Insurance Code §10489.2(a) for the valuation of whole life insurance issued on the same date as the disability insurance contract;

(ii) for disabled lives the mortality basis, if any, shall be according to a table (but without select factors) permitted by Insurance Code §10489.2(a) for the valuation of whole life insurance issued on the same date as the claim incurred date.

(2) For long-term care insurance individual policies or group certificates issued on or after January 1, 2005, the mortality basis used shall be the 1994 Group Annuity Mortality Static Table.

(3) ~~(2)~~ Other mortality rates may be used in the calculation of the minimum reserves, if appropriate for the type of benefits and if approved by the Commissioner. The request for such approval must include the proposed mortality basis and the reason that the standard specified in paragraph (1) or (2) is inappropriate.

Authority. -- Sections 997(a) and 10489.95, Insurance Code. Reference: Sections 985, 997 and 10489.15(a), Insurance Code.